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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

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Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Court of Appeal for the following reason:

This case does not present a substantial federal question.

INTRODUCTORY STATEMENT AND SUMMARY OF ARGUMENT

Appellant Chase Brass and Copper Co. (hereinafter referred to as "Chase") has brought this matter to this Court before. In 1970, after analyzing the Stipulation of

Facts, the numerous exhibits admitted into evidence and the testimony of the witnesses offered by appellant, the California Court of Appeal concluded that the undisputed facts demonstrated as a matter of law that the activities of Kennecott Copper Corporation (hereinafter referred to as "Kennecott") and three of its wholly-owned subsidiaries (Chase, Kennecott Wire and Kennecott Sales) were dependent upon each other to the extent that it was proper to treat the operations of the group as a "unitary" business.[1] Accordingly, since Chase was doing business in California, the Court held that for purposes of the California franchise tax measured by net income it was proper to compute the amount of income attributable to Chase's California activities by applying a fair apportionment formula to the total unitary net income of the business of which Chase was a part. *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 87 Cal. Rptr. 239. That decision shall hereinafter be referred to as *Chase I;* said decision is presented in full as Appendix B to Chase's jurisdictional statement, and citations herein to that decision shall be to the pages of said appendix. (The jurisdictional statement shall be cited herein as "J.S."; pages in the jurisdictional statement's appendices shall be cited herein as "J.S. App.").

After unsuccessfully seeking a hearing in the California Supreme Court, Chase appealed *Chase I* to this Court, claiming that the decision was unconstitutional. On December 21, 1970, this Court ordered as follows:

> "Appeal dismissed for want of jurisdiction. Treating the papers whereon the appeal was taken as a petition for writ of certiorari, certiorari denied." *Chase Brass & Copper Co. v. Franchise Tax Board of California* (1970) 400 U.S. 961.[2]

1. The Court held that two other wholly-owned subsidiaries of Kennecott (Bear Creek and Braden) were not part of the unitary business.

Upon remand, the California Superior Court decided most of the issues contrary to Chase's position. The trial court's findings of fact, conclusions of law and judgment are contained as Appendix C to the jurisdictional statement (J.S. App. 24-27). That court's decision on remand was affirmed on cross-appeals in the California Court of Appeal. *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1977) 70 Cal.App.3d 457, *modified,* 71 Cal.App.3d 471c, 138 Cal. Rptr. 901. This second appellate decision shall be referred to herein as *"Chase II";* citation thereto shall be to the opinion as included as Appendix D to the jurisdictional statement. Cross-petitions for hearing in the California Supreme Court were denied, and Chase has again appealed the matter to this Court, raising many of the same grounds Chase argued to this Court in 1970.

In our Argument, which follows a brief statement relating to the facts, we shall demonstrate that there is no merit to appellant's contentions and that the decision of the California Court of Appeal is in accord with established decisions of this Court. The following is offered as a fair summary of the Argument.

2. From the first sentence Chase argues (J.S. 4) that this Court's dismissal was not on the merits but was a result of the state decision, which ordered a remand for further determinations, not being final. However, from the second sentence is it reasonable to conclude that the Court felt that the judgment was "final" and ripe for review, but that its jurisdiction to review came by way of certiorari under 28 U.S.C. § 1257(3) rather than by way of appeal under 28 U.S.C. § 1257(2). It would be reasonable to conclude that the state court judgment did not uphold the validity of a state statute (a prerequisite to jurisdiction to review the case by appeal under section 1257(2)) but simply rejected the taxpayer's claim that its federal rights prevented the application of the statute to it (which would be reviewable only by certiorari under section 1257(3)).

I. In order that this Court can view this case in context, we will first set forth a brief summary of the theory underlying California's approach to corporate income taxation. In that regard, we shall point out that California still follows the "unitary business" concept approved by this Court in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. In applying the unitary business concept, California stresses substance over form. Accordingly, the unitary business rule is applied regardless of whether the related activities are carried on within the framework of a single corporate entity, as in *Butler Bros.*, or by a parent and a group of wholly-owned subsidiaries, as in *John Deere Plow Co. v. Franchise Tax Bd.* (1951) 38 Cal.2d 214, 238 P.2d 569, *appeal dismissed* 343 U.S. 939.

II. Next, we shall apply the theory to the undisputed facts in this case and show that, beyond any doubt, the activities of the four corporations now involved here were interrelated to the extent that it was proper to treat the entire group as a unitary business. Essentially, Kennecott and its subsidiaries are engaged in an integrated copper business, with activities ranging from mining the copper ore down to selling fabricated copper products to consumers. Kennecott mines, concentrates, smelts and refines virgin copper. Chase and Kennecott Wire are copper fabricators. They are dependent upon Kennecott for their basic raw material, refined copper. Kennecott Sales is the intermediary which handles the sales of refined copper. Thus, the corporations present the classic example of a vertically structured business. There existed between the corporations the degree of intercompany contacts that are normally expected in a vertically structured business of this type.

III. Our third section merely points out the application by California of the standard three-factor formula of property, payroll and sales to the unitary business. Chase's challenges to this application are answered in later sections.

IV. In the fourth section of our Argument, we shall point out the errors in Chase's contentions. In its Jurisdictional Statement, appellant makes numerous assertions to support its position. The arguments are untitled and there are no section headings. In many instances, the contentions overlap and it is difficult to tell exactly what Chase's legal position is, except that it does not like its income computed by the combined unitary method. We shall attempt to pick out the factors relied upon most heavily by Chase and demonstrate why the arguments based thereon are unmeritorious.

A. Chase bases much of its appeal on a completely baseless argument that California's holding that a unitary business existed was based solely on Kennecott's ownership of the stock of its subsidiaries. The ridiculous nature of this argument will be discussed.

B. Chase stresses the fact that the activities of Chase, Kennecott Wire and Kennecott Sales were carried on by wholly-owned subsidiaries of Kennecott rather than by divisions of Kennecott itself. We do not believe that it is unconstitutional to look to the substance of the business, rather than be controlled by the form in which the business is carried on. To accept appellant's apparent position in that regard would be to write a blueprint for tax avoidance whereby even the most unitary of businesses could lower their State taxes simply by changing the form in which they conduct business. For example, the operations of General Motors Corporation unquestionably present a uni-

tary business situation. See *General Motors Corp. v. District of Columbia* (1965) 380 U.S. 553. Yet, under appellant's approach, General Motors could create "separate businesses" by separately incorporating individual portions of its activities.

C. Chase's claims that California is taxing Kennecott's property and income ignores the function of the factor apportionment of net income of a unitary business. To the contrary, application of the factors to the net income of the entire unitary business merely determines the net income of the *California* business, which was carried on entirely by Chase.

D. Chase confuses combined reporting of all segments of a unitary business with the consolidation procedures which are necessitated when two or more corporations have artificially shifted income between themselves for tax purposes. Such intentional shifting is not a prerequisite to a determination that a unitary business exists.

E. Chase's contention that the unitary rule cannot be followed in franchise tax cases is answered by reference to common sense and to this Court's action in *John Deere Plow Co. v. Franchise Tax Board* (1951) 38 Cal.2d 214, 238 P.2d 569, *appeal dismissed*, 343 U.S. 939 (1952).

F. Chase doggedly attempts to use separate accounting to impeach California's use of the standard three-factor formula in determining the true California net income. These attempts are made in spite of a clear holding by this Court contrary to Chase's position in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. Chase's heavy reliance on an ad valorem property tax case (*Norfolk & Western Ry. v. Missouri Tax Comm.* (1968) 390 U.S. 317) is misplaced, as there is a great difference between determining what

items of property are within a state at a particular time and determining what portion of a multi-state unitary business' annual net income should be attributed to a state. For one thing, the "enhancement" theory applicable in property tax cases is not applicable here. Chase's reliance upon *Hans Rees' Sons v. No. Carolina* (1931) 283 U.S. 123, is also misplaced, as such reliance does not take into account the effect of this Court's later decision in the *Butler Bros.* case. Finally, Chase's separate accounting use of the 1955 flood loss is shown to be an example of how Chase ignores the unitary concept: the California result acknowledges that said flood loss was indeed a real loss, and said loss was fully reflected in the determination of the unitary net income for that year.

G. Based solely on the fact that California has not specifically quoted one segment of one of this Court's decisions, Chase makes the surprising (and ludicrous) claim that California will not permit any constitutional attack on results reached in any case by application of formulary apportionment of unitary net income. We shall show that California has always recognized this Court's rule that clear and cogent evidence (which does not include separate accounting) will always be admitted in considering any such challenge.

H. Chase has pointed to no clear and cogent evidence to support the challenges it raises in its jurisdictional statement to the computation below of the property and payroll factors.

I. Chase's challenge on multiple taxation grounds to the California application of the standard three-factor formula is contrary to Chase's own 1972 recognition that Utah's deviation from the standard approach (in *Kennecott Copper Corp., et al. v. State Tax Commission of Utah* (1972) 27 Utah 2d 119, 493 P.2d 632, *appeal dismissed*,

409 U.S. 973) would have no effect on the validity of other states' using that standard approach. We shall show that Chase was right on this point in 1972. Also, the tax years involved in the present case are considerably earlier than the Utah enactment giving rise to the Utah case; thus there is no way that the Utah case could result in multiple taxation with regard to California liabilities for the years here in issue.

V. Finally, we refer to the arguments of the amici curiae, which are sufficiently answered in the rest of this motion to dismiss or affirm.

STATEMENT REGARDING THE FACTS

Before beginning our argument, it is appropriate to comment upon appellant's statement of the facts. The factual record in this case is voluminous. It consists of a lengthy stipulation of facts, a thick stack of exhibits and testimony of witnesses offered by appellant. Although the record is large, none of the facts are disputed. Since the facts are undisputed, the California Court of Appeal was presented solely with a question of law. Some of the numerous cases which so hold are cited in the *Chase* I decision in this case. Accordingly, the so-called "findings" of the trial court which are merely mislabeled conclusions of law are not binding on appeal. J.S. App. 15-16. Yet, it is these conclusionary statements of the trial judge upon which appellant relies most heavily. For example, on page 11, appellant quotes in full the statement of the trial judge to the effect that the apportionment formula operates to assign Kennecott's income to Chase. While treating such erroneous legal conclusions as undisputed facts tends to make appellant's job easier, it indicates that this Court should be careful not to accept as true appellant's conclusionary statements regarding the factual relationship that existed between Kennecott and its subsidiaries.

Chase's jurisdictional statement stresses those facts which tend to support the legal conclusion it seeks and ignores many undisputed facts which point the other way. Thus, appellant treats the operations of Kennecott's fabricating subsidiaries (including Chase) as in no way benefiting Kennecott's income producing activities. But appellant fails to tell this Court that it is an undisputed fact that in 1958 the vice-president of Kennecott recommended that the Board of Directors of Kennecott approve the acquisition of yet another fabricator because, in the language of Kennecott's executive:

> ". . . the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper . . ." (Stipulation Exhibit F)

See *United States v. Kennecott Copper Corporation* (1964) 231 F.Supp. 95, *affirmed* 381 U.S. 414, wherein the acquisition of the fabricator was held to be a violation of the anti-trust laws. Again, appellant would have this Court believe that Kennecott treated its fabricating subsidiaries the same as it treated independent fabricators. But when Chase in its argument quotes from the stipulation regarding the lines of authority and responsibility between the corporations, Chase omits the fact that "[t]he executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." J.S. App. 63-64. Chase also fails to state such facts as that the undisputed evidence shows that the president of Kennecott had a special assistant whose job was to assist the subsidiary companies with their engineering problems. (Stipulation Exhibit B, p. 20.)

We shall demonstrate that the facts actually before the California Court of Appeal support the Court's legal conclusions.

ARGUMENT

1. In Computing Income from California Sources, California Follows the "Unitary Business" Concept.

There is no national law which dictates the precise manner in which the states must allocate income for tax purposes. In our federal system, each state is allowed, subject to limitations imposed by the Constitution and the Congress in exercise of its powers, to adopt that method of computing income taxable in the state which best suits its particular needs. Because of the wide diversity of economic, political and business conditions that exist throughout our nation, it is no wonder that there is no uniform approach to the taxation of income of corporations that do business in more than one state.[3] We believe that the California approach is the most logical. However, so that this Court can view in context the California method here challenged by appellant, it is appropriate to very briefly outline the various alternatives.

Essentially, there are two different accounting methods that can be used to determine the amount of operating income attributable to a corporation's activities in the state, namely, separate accounting and formula apportionment. Under the separate accounting method, consideration is given only to the gross income and expense items directly related to instate activities.[4] Under this approach, a corpo-

3. The various methods of allocation and apportionment are described and discussed in detail in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 88 Cong., 2d Sess., H.R. No. 1480, June 5, 1964, Vol. 1, Chap. 7, on "Division of Income," at 155-249. Hereinafter, this report will be referred to as the Willis Subcommittee Report.

4. Separate accounting also occurs when net income is separately computed for only a portion of a unitary business, even though that portion encompasses business done in several states. *RKO Teleradio Pictures, Inc. v. Franchise Tax Board* (1966) 246 Cal.App.2d 812, 816-18, 55 Cal. Rptr. 299, 302-04.

ration could have net income in one state and losses in other states. Under the formula apportionment method, the net income of the entire operation is apportioned by formula between the various states in which the business is conducted. While there is no specific apportionment method required to be used by all states, the formula used most frequently is the three-factor formula of property, payroll and sales.

As indicated in the Willis Subcommittee Report, some states have a statutory preference for the separate accounting method whereas other states require the formula to be used in all cases. California does not fall into either of those extremes. California follows what has sometimes been referred to as the "unitary business" rule, whereby the formula apportionment method is applied only to "unitary" businesses. Accordingly, if the activities of the taxpayer in the state are non-unitary in character, then the amount of income attributable to those activities is determined by the separate accounting method. On the other hand, if the California activities are just part of a unitary business conducted both within and without California, the amount of income attributable to the California portion of the business is determined by the formula apportionment method. This Court expressly upheld the California method in *Butler Bros. v. McColgan* (1942) 315 U.S. 501.[5]

5. The rule has been applied consistently by the California courts under the statutes in effect during the years at issue here, regardless of whether the effect is to raise the amount of income attributable to California sources, as in *Butler Bros.*, or to lower the amount of income attributable to California sources, as in *Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal. 2d 406, 34 Cal. Rptr. 545, 386 P.2d 33, and *Honolulu Oil Corp. v. Franchise Tax Bd.* (1963) 60 Cal. 2d 417, 34 Cal. Rptr. 552, 386 P.2d 40.

Determining the scope or boundaries of the unitary business to which the formula is to be applied is not always easy and is a problem to which not all states have given the same solution. Not all business operations, particularly in this age of mergers and acquisitions, are as straightforward as in the *Butler Bros.* case. In *Butler Bros.,* the operations there held to be unitary were all conducted within the framework of a single corporate entity. Moreover, that corporate entity conducted no business operations in addition to those considered in the case. There are literally thousands of situations, however, where the boundaries of the unitary business and the corporate entity are not coterminous. There are numerous conglomerates that operate several distinct businesses within one corporate entity. On the other hand, there are numerous examples of a single business operation conducted by a group of affiliated corporations.

There are those states that, rather than attempting to solve the problem, simply let form control. Thus, all the income of a single corporation must be apportioned by a single apportionment formula, regardless of how unrelated the activities of the various corporate divisions might be. On the other hand, the combined apportionment method is never used, regardless of how dependent the corporation's activities are with those of affiliated corporations.

Again, California does not take this simple, but extreme, approach. California believes that, in conformity with the decision of this Court in *Butler Bros. v. McColgan, supra,* it is the income of a unitary business which should be apportioned by formula, regardless of the form in which that business is conducted. For example, assume a conglomerate had one division that produced and distributed motion pictures, another division which manufactured and sold

pharmaceutical products and yet another division which conducted aerospace research for the federal government. California would treat each division as a separate business and apportion the income of each business between the states in which such business was conducted. Likewise, if a parent corporation and its subsidiaries were engaged in a single unitary business, California would compute the amount of income attributable to California sources by applying an apportionment formula to the net income of the entire business.

Thus, in administering the California franchise tax, the Franchise Tax Board stresses substance over form and applies the unitary concept to all unitary businesses, regardless of the form in which that business is conducted. We believe that this appoach is logical and rational. We know of no decision of this Court which even hints that this approach is unconstitutional. However, in the current appeal Chase argues that the application of the unitary concept has resulted in unconstitutional taxation of property and income of individual corporations which do no direct business in California.

In that regard, it is appropriate to note that application of the combined unitary method to unitary businesses conducted in multicorporate form is nothing new or novel. It has been followed in California since the early years of the California franchise tax, which was originally enacted in 1929. Since the inception of the franchise tax, use by California of the combined unitary method, *per se,* has been challenged in the courts only once, in addition to the instant case. That was the case of *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 183 P.2d 16, which dealt with the income years 1936 and 1937. In *Edison Stores,* the California Supreme Court rejected the argument that use

of the combined unitary method resulted in taxing extra-territorial values and held that such method was authorized by statute and was consistent with constitutional principles. The Court also found no difference in principle between a single-corporation unitary business and a multiple-corporation unitary business:

> "[T]he business is unitary regardless of the fact that in the Butler Brothers case there was but one corporation involved, owning as parts of the unitary system seven different branches in as many states, and that in the present case there is a parent corporation owning and controlling as units of one system fifteen different branches organized as corporations in as many states. No difference in principle is discernable. If the crux of the matter is to ascertain that portion of the business which is done within this state, then the same considerations justify the use of the formula allocation method in the one case as in the other." *Id.* at 480; 183 P.2d at 21.

The fact that in more than four decades only one other taxpayer has challenged the use of the combined unitary method *per se* is strong evidence that taxpayers generally feel that such method is proper, constitutional, and generally productive of the correct result. As stated by Justice Cardozo in *Coler v. Corn Exchange Bank,* (1928) 250 N.Y. 136; 164 N.E. 882, 884:

> "Not lightly vacated is the verdict of quiescent years."

Moreover, throughout the years various legal writers have commented upon the combined unitary method and recognized it as a proper method of computing income. See, for example, Altman & Keesling, *Allocation of Income in State Taxation,* 2d ed (1950), pp. 169-178; Keesling & Warren, "The Unitary Concept in the Allocation of In-

come," 12 Hastings Law Journal 42, 57; Hellerstein, "Recent Developments in State Tax Apportionment and Circumscription of Unitary Business," 21 National Tax Journal 487; Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups," 25 Tax Law Review 171, 194. We know of no writer who has suggested that use of the combined unitary method is *per se* unconstitutional.

We submit that it cannot be seriously disputed that if a parent corporation and its wholly-owned subsidiaries are engaged in a unitary business within and without California, the Franchise Tax Board may properly determine the amount of income attributable to California sources by the combined unitary method.

II. The Activities of Kennecott, Kennecott Sales, Chase and Kennecott Wire Constitute a Unitary Business.

It takes only a moment's reflection to realize that the question of what constitutes a unitary business cannot be answered by a simple checklist of objective facts. The range of business relationships is far too varied. Some unitary businesses are horizontally structured enterprises, such as in *Butler Bros. v. McColgan,* (1942) 315 U.S. 501. Other unitary businesses are vertically structured enterprises, such as in *Underwood Typewriter Co. v. Chamberlain,* (1920) 254 U.S. 113. Yet other unitary businesses are such because of strong central management, common financing and centralized departments which handle such matters as accounting and insurance which tie together otherwise operationally independent divisions, such as in *General Motors Corp. v. District of Columbia,* (1965) 380 U.S. 553. It is readily apparent that the type of fact which indicates

that a horizontally structured business is unitary, such as centralized purchasing of a product sold by all branches, will ordinarily not be present in a vertically structured business. Therefore, a general test is needed.

A succinct statement of the general rule which has consistently been followed by the California courts and which was followed by the California Court of Appeal in the instant case was made by the California Supreme Court in *Edison California Stores v. McColgan* (1949) 30 Cal.2d 472, at 481; 183 P.2d 16, at 21:

> "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary; . . ."

Surely that statement captures the essence of the rule. The unitary principle applies and formula apportionment is proper when the activities of one member of the affiliated group are dependent upon or contribute to the activities of the other corporations and the success of the group as a whole.

It cannot seriously be denied that the test of mutual contribution and dependence is fully satisfied in this case. Kennecott and its subsidiaries present a clear-cut example of a vertically structured manufacturing and selling business which by its very nature constitutes a unitary business.

As a group, Kennecott and its copper selling and fabricating subsidiaries are engaged in various phases of the copper business, from mine to consumer. Kennecott mines, concentrates, smelts and refines the copper ore. Chase and Kennecott Wire take refined copper and convert it into consumer products. Surely the entire operation is a unitary business. To contend that the fabricating operations of

Chase and Kennecott Wire are truly independent businesses is equivalent to contending that the assembly plant operations of General Motors constitute a separate business. The contention would be preposterous.

The dependence of Chase and Kennecott Wire upon Kennecott is undisputed. There are only three large producers of refined copper in the United States—Kennecott, Anaconda and Phelps Dodge. Undisputed testimony proved that Anaconda and Phelps Dodge sell most, if not all, their refined copper to their fabricating subsidiaries. Thus, if Chase and Kennecott Wire were to acquire refined copper, their basic raw material, at a competitive price, it had to come from Kennecott. During the period involved in this litigation, the only other source of domestic copper was the "custom smelters", whose price was higher.

Chase and Kennecott Wire, on the other hand, contributed to the success of Kennecott. Appellant's attempt to have this Court treat the activities of Chase as a separate business in which Kennecott has no interest other than that of a shareholder who has invested some idle funds completely overlooks the history and structure of the copper industry. It is not possible to brush off Chase's reliance on Kennecott and Kennecott's use of Chase as nothing more than mere market place encounters of an independent buyer and seller.

It is certainly not appropriate here to go into detail on all the economic advantages realized by a mining company which controls a fabricating subsidiary or how the ownership of a fabricator aids the mining parent in its attempt to control and stabilize the price of the metals market. The vital relationship between copper producer and copper fabricator is vividly displayed by Kennecott's

attempt to acquire the Okonite Company. Following a study of Kennecott's position in the copper market, in 1958 Frank R. Milliken, then a vice-president of Kennecott, submitted a memorandum entitled "Acquisition of the Okonite Company" to the Board of Directors of Kennecott. The memorandum states in part:

> "It is recommended that Kennecott acquire The Okonite Company, producers of insulated wire and cable, because the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper and will also provide a second profit on copper produced." (Stipulation, Exhibit F.)

The California Court of Appeal in *Chase* I recognized that, although federal law required Kennecott to sell to Chase and to Chase's competitors at the same price, Kennecott's control of Chase provided Kennecott with a guaranteed buyer of a substantial portion of Kennecott's production. J.S. App. 21.

From the fabricator's point of view, Chase's witness testified that if it were not for Kennecott, Chase and Kennecott Wire simply would not have a source of supply of copper. RT (1966) 122. It is hard to imagine a situation of greater dependence upon the parent corporation.

It is submitted that each of the members of the Kennecott family of corporations involved in this case played a vital role in the copper business owned and controlled by Kennecott. Chase and Kennecott Wire both played significant parts in that unitary business.

In its Jurisdictional Statement, appellant all but ignores these overwhelming facts showing contribution and dependency. Rather, appellant concentrates on the significant, but less important, factors such as common retirement

plans, executive control of salaries, etc. In doing so, appellant does a disservice to the Franchise Tax Board and to the opinion of the California Court of Appeal. The Franchise Tax Board's determination to use the combined unitary approach in this case was based essentially on the fact that Chase and Kennecott Wire were dependent upon Kennecott for their basic raw material. The facts discussed by appellant are merely supplemental and give further proof of the unitary nature of the business. Individually they are not the touchstone of the Board's determination. For example, if Chase were not in the copper fabricating business but did nothing more than produce motion pictures for television, the Board would not have used the combined unitary method, regardless of the fact that some common retirement plans existed.

Chase apparently recognizes that it cannot expect success if it presents the facts in a fair manner in its argument. Thus in quoting from the stipulation of facts on page 8 of its jurisdictional statement Chase deletes the following rather key fact:

> "The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." (Stipulation ¶ 5(a).)

Although Chase later (J.S. 18) recognizes that the Court in *Chase* I noted the subsidiaries' reporting of major policy matters to Kennecott, Chase fails to note the following statement in *Chase* I:

> "The major policy matters are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott." J.S. App. 19.

The purchasing, advertising, accounting,[6] legal, financial, retirement, policy, salary, sales and purchases links set out on pages 12 and 13 of the jurisdictional statement is an incomplete list of all the interconnecting factors within the multicorporate unitary business. There was also some intercorporate insurance coverage when it was beneficial (J.S. App. 17, 70-71); furthermore, Kennecott, by central control, determined the horizontal interrelationship between Chase and Kennecott Wire (J.S. App. 19);[7] on infrequent occasions there were loans of specialized personnel from Chase to Kennecott and from Kennecott to Chase (J.S. App. 74); Kennecott's annual reports interchangeably referred to Chase and Kennecott Wire as "fabricating subsidiaries" (Stip. Exh. A) and as its "fabricating divisions" (Stip. Exhs. B, C) and referred to the coordinated research and development activities of Chase and Kennecott regarding metals in which Kennecott was interested (Stip. Exhibits A, B, C).

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6. Chase mistakenly accuses (J.S. 12) the Court of Appeal in *Chase* I of saying Chase and Kennecott filed consolidated tax returns; the *Chase* I decision (J.S. App. 17) spoke of consolidated tax "accounts", relying on the statement regarding consolidated accounting and tax reports in paragraph 19(f) of the stipulation (J.S. App. 73).

7. It was the "major part" of the sales of Kennecott Wire's products which Chase assumed, with orders filled and shipped in the names of Chase (J.S. App. 20, 66); during the years in question Chase did the accounting and reviewed taxes for Kennecott Wire (J.S. 20, 73); a president and a general sales manager for Kennecott Wire came from Chase (J.S. 20, 71).

Thus the record is clear in establishing the dependent and contributory nature of the operation of this multicorporate unitary business, both in the vital area of supply and sales of Kennecott's basic product, copper, and in the area of intercorporate unity of ownership, operation, and use. *Chase* I and *Chase* II properly held that Chase was engaged in a unitary business with Kennecott, Kennecott Sales, and Kennecott Wire.

III. California Has Properly Applied the Standard Three-Factor Formula to the Unitary Net Income in Determining What Portion of That Net Income Was Attributable to California.

California in this case applied the standard three-factor formula of property, payroll and sales to determine the amount of unitary net income attributable to California. California's application of this formula to unitary businesses was approved by this Court in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. The general use of the "standard three-factor formula" has been noted with approval by this Court in *Gen. Motors v. District of Columbia* (1965) 380 U.S. 553, 559, 561. The California Court of Appeal in its *Chase* II opinion presents a well-reasoned response (J.S. App. 40-54) to the myriad challenges Chase raised below to the Board's application of this formula in this case. The specific challenges raised in Chase's jurisdictional statement shall be dealt with below.

IV. The Facts Relied Upon by Appellant Are Not Persuasive. Appellant's Legal Arguments Are Unsupportable.

It is often difficult to discern separately each argument Chase is attempting to make in its jurisdictional statement. In this section we shall attempt to pick out the factors and legal contentions relied upon most heavily by appellant and demonstrate the errors in Chase's position.

A. CONTRARY TO CHASE'S CONTENTION, THE RESULT BELOW WAS BASED ON MUCH MORE THAN COMMON OWNERSHIP OF THE COMPANIES INVOLVED IN THE UNITARY BUSINESS.

The close interrelationship between Chase, Kennecott, and the other companies formed in *Chase* I and II to be engaged in the unitary business has been summarized above at pages 15-21 and in the *Chase* I decision (J.S. App. 12-14, 16-21). Chase sets forth some of the facts showing this interrelationship at pages 12 and 13 of its jurisdictional statement. Yet during the course of its jurisdictional statement Chase impliedly recognizes how tenuous its position is in this matter under the facts as they actually existed. Thus Chase is reduced to a claim that "[t]he tax imposed is imposed solely because Chase's stock is owned by a single corporation. . . ." J.S. 32. Similar statements occur through Chase's jurisdictional statement. J.S. 18, 19, 24, 32, 33, 34.

A reading of *Chase* I and *Chase* II reveals the ridiculous nature of Chase's desperate claim. Unity of ownership was only one test in determining the unitary nature of the business herein involved. It was discussed in three sentences in *Chase* I. J.S. 16, 20. Although unity of ownership was necessary to a conclusion that a unitary business existed, the other tests and reviews of interrelationships discussed above at pages 15-21 were also made in reaching that conclusion. Furthermore, *Chase* I found two other wholly owned subsidiaries of Kennecott (Braden Copper Company and Bear Creek Mining Company) to *not* be part of the unitary business which included the other corporations (J.S. App. 21-22).

Chase's appeal apparently is built upon the foundation of its claim that the finding of a unitary business was based solely upon Kennecott's ownership of its subsidiaries, including Chase. That foundation is totally without support in the record.

B. THE FACT THAT CHASE, KENNECOTT WIRE AND KENNECOTT SALES ARE SEPARATELY INCORPORATED IS NOT DETERMINATIVE.

Appellant appears to lay great stress (J.S. 17, 20) upon the fact that Chase is separately incorporated. Appellant's reliance upon that fact is misplaced. As demonstrated earlier, the unitary concept applies to all corporate activities that are tied together by mutual contribution and dependence. For decades the Franchise Tax Board and the California Courts have applied the rule based on the substance of the activities in question rather than by the form in which the activities are carried on. *See Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 183 P.2d 16.

To have determinations based on substance rather than form is just plain good common sense. While some states might elect to be bound by form, surely there is nothing in the United States Constitution that would require California to recognize form over substance. There is no constitutional principle which guarantees corporations the right to change their state tax consequences merely by changing the form in which they do business. In *Helvering v. Lazarus & Co.* (1939) 308 U.S. 252, this Court, in holding that a sale and lease back of real property was in reality a mortgage, stated, at page 255,

> "In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, . . ."

Suppose that Kennecott, as sole shareholder of Chase, Kennecott Wire and Kennecott Sales, elected to reorganize and merge each of the subsidiaries into Kennecott. It could do so very easily without any material alteration in operational practice. Any changes would be merely formal. For example, the title of the individual who is the head of

Chase would be changed from "President" of Chase to, possibly, "Vice President: Chase Division" of Kennecott. If such a merger did occur, then Kennecott itself would be doing business in California and no one would seriously question the right of California to compute the measure of its franchise tax by applying an apportionment formula to the net income of the corporation. A different result should not be reached simply because Kennecott has certain portions of its business conducted by wholly-owned subsidiaries rather than by divisions of the parent company.[8]

C. CONTRARY TO CHASE'S ARGUMENTS, CALIFORNIA IS NOT TAXING KENNECOTT; IT IS TAXING CHASE WITH A TAX MEASURED BY THE PORTION OF THE UNITARY BUSINESS' NET INCOME ATTRIBUTABLE TO CHASE'S CALIFORNIA ACTIVITIES.

Chase argues (J.S. 14-16, 18) that California is taxing *Kennecott's* property and income although Kennecott does no business in California. This argument has no weight once the unitary relationship between Chase and Kennecott is established. California is not attempting to levy any kind of tax on Kennecott for the years involved. Application of the apportionment formula to the entire unitary business does not result in a taxing of Kennecott's income, or even a taxing of Chase's income from its activities outside California. Rather, the formula just tells us the true amount of income attributable to Chase's activities in California. *See Butler Bros. v. McColgan* (1942) 315 U.S. 501, 506, 509.

8. As noted above, Kennecott's annual reports for the years involved interchangeably referred to Chase and Kennecott Wire as "fabricating subsidiaries" (Stip. Exh. A) and as "fabricating divisions" (Stip. Exhs. B, C).

D. BEFORE FINDING THAT A UNITARY BUSINESS EXISTS, THERE IS NO NEED TO ESTABLISH THAT ACCOUNTING PROCEDURES HAVE BEEN USED TO SHIFT INCOME ARTIFICIALLY BETWEEN CORPORATIONS.

Throughout its jurisdictional statement Chase has referred to the "consolidation" of Chase with Kennecott and other corporations. J.S. 7, 9, 11 n. 5, 19, 21, 22, 24. Although the term "consolidation" is used sometimes to describe the process of determining that corporations are combined in engaging in a unitary business, that term can also be applied to a situation where consolidated returns are required solely because a parent company has artificially shifted income between companies for tax purposes. These are two different situations, governed by two separate statutes in California. Cal. Rev. & Tax. Code §§ 25101, 25104 (set forth in Appendix A attached hereto). The power to apply unitary formula allocation is not derived from the power to require consolidated returns of two or more corporations. *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 480; 183 P.2d 16. Thus to find a unitary business there is no need, as Chase suggests (J.S. 20-21, 32-34), to establish that there was intentional falsification or bad faith in the manner of bookkeeping. *See id.* at 475.

E. THE UNITARY CONCEPT IS VALID IN FRANCHISE TAX CASES AS WELL AS INCOME TAX CASES.

Appellant apparently contends (J.S. 23-24) that even if Kennecott and its subsidiaries constitute a unitary business, the unitary rule cannot be followed because this is a franchise tax case, not an income tax case. That argument demonstrates the lengths to which appellant feels it necessary to go in order to find an argument to support its position.

It is ridiculous to contend that the combined unitary method is valid in income tax cases but invalid *per se* in franchise tax cases. The issue would be the same in either

case, namely, has California used a reasonable method to compute the amount of income attributable to California sources? If the combined unitary method is a proper accounting technique to determine the amount of income attributable to California sources for income tax purposes, it most certainly would be a proper accounting technique for franchise tax purposes.

The action by this Court in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal.2d 214, 238 P.2d 569, is significant. In *John Deere* the California Supreme Court upheld the application of the combined unitary concept to a group of 85 affiliated corporations engaged in a unitary business. Of that affiliated unitary group, only one subsidiary did business in California. The tax involved was the California franchise tax, the very same tax which is involved in this case. The taxpayer appealed to this Court. This Court, in a *per curiam* opinion, cited *Butler Bros. v. McColgan, supra,* and dismissed the appeal for want of a substantial federal question, 343 U.S. 939. That action certainly refutes the contention that use of the combined unitary method is invalid *per* se in franchise tax cases.

F. UNDER BUTLER BROS. V. McCOLGAN A TAXPAYER MAY NOT USE SEPARATE ACCOUNTING TO REFUTE THE CALIFORNIA NET INCOME DETERMINED BY APPLICATION BY THE THREE-FACTOR FORMULA; CHASE'S RELIANCE ON THIS COURT'S DECISIONS IN NORFOLK & WESTERN RY. V. MISSOURI TAX COMM. AND HANS REES' SONS V. NO. CAROLINA IS MISPLACED.

The heart of Chase's jurisdictional statement (J.S. 18-22) consists of attempts by Chase to use figures from the separate books of Chase and Kennecott to impeach the procedures used and the results reached in applying the three-factor formula to reach California net income. This is exactly the sort of separate accounting which this Court has determined cannot be used for such purposes. *Butler*

Bros. v. McColgan (1942) 315 U.S. 501. Chase relies on two cases in an attempt to support its approach. They shall be discussed separately.

1. Norfolk & Western Ry. v. Missouri Tax Comm.

The one legal decision relied on more than any other by appellant is *Norfolk & Western Ry. v. Missouri Tax Comm.* (1968) 390 U.S. 317. We submit that a close reading of the case reveals that appellant's reliance is misplaced.

The *Norfolk & Western* case did not involve the proper methods of taxing the income of a multistate business. Rather, the question presented involved determining the value of railroad rolling stock in the State of Missouri on tax day for ad valorem property tax purposes. Missouri arrived at the assessment of rolling stock by first determining the value of all rolling stock of the railroad regardless of where located. That figure ($513,309,877) and the method of its derivation were not in issue. That figure was then equalized to bring it to the relative level of other Missouri property assessments. Missouri next determined the percentage of track of the railroad system located in that state and applied that percentage to the equalized total value of the rolling stock to arrive at the assessed valuation of rolling stock in Missouri. This method proceeded on the assumption that as a matter of fact on tax lien day the rolling stock of the railroad was evenly distributed throughout the railroad's system. That factual assumption was proven to be false because the railroad was able to show by actual inventory count the rolling stock in Missouri on tax day. The railroad, using the same valuation method as the state but determining the value of its rolling stock in Missouri by reference to the actual inventory count, determined that the proper assessed value was approximately $7,600,000,

while the factual assumption adopted by Missouri yielded an assessed value of $19,981,000. Since there was no dispute as to the total value of all the railroad's rolling stock, the only matter to be determined by the Tax Commission was how much of that rolling stock was in Missouri on tax lien day. It is quite obvious that this Court correctly determined that the Tax Commission had miscalculated. It was as if the Tax Commission had said, "Mr. Railroad, I have determined that on tax lien day you had 100 railroad cars in Missouri," and the railroad was able to show by actual count that it had only 75 cars in Missouri on that day.

It is also clear from the opinion why this Court could not sustain the assessment based on any theory of "enhanced" value. Property within a state may have an "enhanced" or "going concern" value that is greater than its value when considered separately. The "enhanced" or "going concern" value attaches to the entire property, considered as a unit. But the Tax Commission was clearly foreclosed from making any such "enchancement" argument on the record in the *Norfolk & Western* case since it had found that the total value of all the rolling stock was $513,309,877. Since that figure was computed by applying depreciation directly to "original cost" figures, *id.* at 321, it was clear that the Tax Commission had *not* included any "enchanced value" factors in its calculations. Moreover, as noted by this Court, the Tax Commission did not rely on any "enhanced" value theory either in making the assessment or when defending the assessment before the Missouri Supreme Court. *Id.* at 323.

Case attempts to use the *Norfolk & Western* case to support Chase's use of separate accounting figures in attacking the California court's holding regarding the net income which has been attributed to California under

the three-factor apportionment. In doing this Chase attempts to evade this Court's clear holding, in *Butler Bros. v. McColgan* (1941) 315 U.S. 501, that separate accounting cannot be used to impeach the formula apportionment of income of a unitary business.

Chase would have this Court treat the measurement and allocation of unitary income exactly the same as the determination of location and valuation of tangible property. There are obvious and immense differences between the two processes. The allocation of unitary net income is not based on an assumption that income is distributed evenly in all states in which the unitary business is active. It does look to the distribution of factors which indicate *contributions* to income. *See Butler Bros. v. McColgan,* 315 U.S. at 509; *Chase* II, J.S. App. 44, 50, 53. While a showing of where property actually was can defeat a contrary assumption in an *ad valorem* property tax situation, a showing (through separate accounting) of where income of a unitary business was actually *received* "wholly fails to sustain" an objection to formula allocation. *Underwood T'Writer Co. v. Chamberlain* (1920) 254 U.S. 113, 120-21; *Butler Bros. v. McColgan,* 315 U.S. 501. This would also apply to a showing of which segment (division, subsidiary, etc.) of the unitary business actually received the income which was generated by the entire unitary business. Thus if a unitary business has as one of its parts a subsidiary corporation which only does research relating to development of products, and if that research subsidiary is totally located in a state in which the unitary business makes no sales, it is clear that income could and should be allocated to that state and to that part of the unitary business even though *no* income is actually received in that state.

The "enhancement" theory discussed in *ad valorem* tax cases such as *Norfolk & Western* has no application in the determination and allocation of the net income of a unitary business. It is impossible to allocate specifically the profits earned by the processes conducted by a unitary business within the borders of a particular state. *Butler Bros. v. McColgan,* 315 U.S. at 507. A fairly calculated formula allocation is used as a reasonable method to attribute such net income to a particular state. *Id.* at 506. The result of such allocation is taken to *be* such net income, and contrary results arising from separate accounting cannot be used to impeach that result. *Id.* at 507. Thus it is not a situation where, as Chase claims (J.S. 23-24), the Board has the burden of proving the "enhancement" of separate accounting results by the existence of unitary relationships in order to reach the formula allocation results;[9] the separate accounting results simply are not relevant as a comparison point to the formula results.

Norfolk & Western Ry. v. Missouri Tax Comm. provides no support for Chase's position.

2. Hans Rees' Sons v. No. Carolina.

Chase also relies upon *Hans Rees' Sons v. No. Carolina* (1931) 283 U.S. 123. In that case this Court found a single-factor formula led to an unreasonable result. It was cited on this basis by the California Supreme Court in *Butler*

9. In fact, the unitary approach to income determination may actually produce a *lower* California tax. *See Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal.2d 406, 386 P.2d 33, and *Honolulu Oil Corp. v. Franchise Tax Bd.* (1963) 60 Cal.2d 417, 386 P.2d 40, wherein the California Supreme Court agreed with the *taxpayers'* insistence that (under the California law as it then existed) formula allocation *must* be applied to *all* unitary businesses, even when the resulting taxes are *less* than those which would result from the application of separate accounting.

Bros. v. McColgan (1941) 17 Cal.2d 664, 672-73, 111 P.2d 334, 339. Later when this Court was considering the *Butler Bros.* case, the *Hans Rees'* decision was cited to support the use of separate accounting to refute the California three-factor formula apportionment. As noted above, this Court in *Butler Bros.* rejected such use of separate accounting. *Butler Bros. v. McColgan* (1942) 315 U.S. 501, 506-09. The *Butler Bros.* treatment of the *Hans Rees'* decision was aptly summarized by the taxpayers *(including Chase and Kennecott)* on page 5 of their petition for rehearing in this Court in *Kennecott Copper Corp. et al. v. State Tax Commission of Utah* (1972), *appeal dismissed,* 409 U.S. 973:

> "(It can be persuasively argued that the *Butler Bros.* case overrules the *Hans Rees'* case since the latter seemingly relies upon separate accounting to impeach formulary apportionment, whereas *Butler Bros.* stands for the proposition that, at least where a unitary business is concerned, separate accounting is inherently incapable of impeaching formulary apportionment.)"

3. Chase's Separate Accounting May Not Be Used to Impeach California's Three-Factor Apportionment.

As shown above in the discussions of the *Norfolk & Western* and the *Hans Rees' Sons* cases, this Court clearly established in *Butler Bros. v. McColgan* (1942) 315 U.S. 501, that separate accounting cannot be utilized to impeach formula apportionment of the net income of a unitary business. That holding was reached in *Butler Bros.* even though the taxpayer's separate accounting, which "admittedly followed recognized accounting principles", *id.* at 505, showed a California loss of $82,851 for the same year that formulary apportionment established a California profit of over $93,500. Chase now refuses to recognize the *Butler Bros.*

holding.[10] Thus in the current case Chase uses separate accounting to attempt to split the unitary business along corporate lines as well as geographical lines (J.S. 19-22).

Even though the *Butler Bros.* case involved a situation when separate accounting showed a California *loss,* Chase tries to distinguish Chase's use of separate accounting regarding the 1955 flood loss on the basis that the loss in *Butler Bros.* had, according to Chase, "no demonstrated cause". J.S. 24-25. Yet, as noted above, no one in *Butler Bros.* questioned the fact that the loss shown under separate accounting was reached by following "recognized accounting principles". It was not necessary in *Butler Bros.* to delineate the cause of whatever financial setback resulted in the loss shown by separate accounting. In each case any such setback had its effect on the entire unitary business, reducing the apportionable unitary income for the year involved. Since the business involved in the current case is unitary, a loss such as the 1955 flood loss served to reduce the unitary net income; such a loss could not validly be attributed through separate accounting to only one of the interdependent parts of the business, as Chase is attempting to do here.

G. CHALLENGES (OTHER THAN BY SEPARATE ACCOUNTING) MAY BE MADE TO THE OUTCOME OF APPLICATION OF THREE-FACTOR FORMULA APPORTIONMENT; HOWEVER, CLEAR AND COGENT EVIDENCE MUST BE PRESENTED BY THE TAXPAYER TO SUPPORT ANY SUCH CHALLENGE.

On pages 25 through 29 of its jurisdictional statement Chase fabricates a classic strawman argument. In its attempt to have this Court accept jurisdiction Chase is making the eyecatching but absurd claim that the California

10. Chase even misapplies (J.S. 23) some federal treasury regulations in what amounts to a claim that said regulations are attempting to overrule this Court's *Butler Bros.* holding.

courts will not consider any challenge to any application of any apportionment formula. Chase bases this claim on the absence of quotation in California cases of one particular passage from *International Harvester Co. v. Evatt* (1947) 329 U.S. 416, 422-23.

In the *International Harvester* decision this Court upheld an Ohio apportionment, noting that "'rough approximation rather than precision' is sufficient." *Id.* at 422. The Court also observed that a state's effort to make an apportionment could be nullified, but only if "a palpably disproportionate result" had come from it. *Id.* at 422-23. Chase's argument is that since the subsequent California decisions have not quoted this last observation, California does not recognize that apportionment can ever be subjected to constitutional attack.

To the contrary, the California courts have always recognized that an apportionment formula can be challenged on constitutional grounds. The California decisions have not quoted the dictum from *International Harvester* on this point;[11] instead they have referred to language from this Court's *Butler Bros.* decision which sets forth the type of burden which must be surmounted by anyone making such a challenge.

In *Butler Bros. v. McColgan* (1942) 315 U.S. 501, 507, this Court noted that "[o]ne who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extra-territorial values being taxed." The California cases consistently have reflected and applied that approach. In *Household Finance*

11. It may be of interest to note that of the eleven times this Court has cited the *International Harvester* decision, the only time the "palpably disproportionate result" language has been quoted was in Mr. Justice Black's dissent in *Norfolk & Western Ry. Co. v. Missouri State Tax Comm'r* (1968) 390 U.S. 317, 332.

Corp. v. Franchise Tax Bd. (1964) 230 Cal.App.2d 926, 931, 41 Cal. Rptr. 565, 568, which Chase cites (J.S. 26) as disregarding the possibility of any attack, the court in fact noted the taxpayer's burden of producing "'clear, cogent evidence'" in attacking the elements of the formula in order to show unfair apportionment to California.

The disingenuous nature of Chase's argument is shown by reference to a case of which Chase is fully aware but which Chase chooses not to cite to this Court. In *McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 Cal.2d 506, 512-15, 72 Cal. Rptr. 465, 468-70, 446 P.2d 313, 316-18, the California Supreme Court referred to the taxpayer's burden as noted in *Butler Bros.* and *held that the taxpayer had satisfied that burden in its attack on how the Franchise Tax Board had computed the property factor* in that case. Chase's attorneys are certainly aware of the *McDonnell Douglas* decision. In fact, it was cited in *Chase* I (J.S. App. 22) as the conceded intervening cause for the need to adjust the property factor in the remand in this case, and it was cited often by both parties in the *Chase* II briefs.

Thus Chase's argument is shown to be utterly false. If the California courts' approach was as stated by Chase, the decision in *Chase* II would have been considerably shorter; however, instead of holding that the apportionment result was immune to attack, the *Chase* II decision considered the many challenges Chase had made to the procedures followed by the Board.[12] Contrary to Chase's argument, the California courts clearly recognize the ability of a taxpayer to challenge an apportionment result.

12. Of course *Chase* II did note and follow (J.S. App. 44-45) the rule from *Butler Bros.* to the effect that an attack which is based upon the application of separate accounting to portions of a unitary business is not an allowable form of challenge. See discussion above at pages 26-32.

H. CHASE HAS PRESENTED NO CLEAR AND COGENT EVIDENCE WHICH WOULD SUPPORT DEVIATIONS FROM THE APPORTIONMENT FORMULA AFFIRMED IN CHASE II.

On pages 35 through 37 of its jurisdictional statement Chase presents two challenges to the formula which was affirmed in *Chase* II; one of those challenges relates solely to the property factor, and the other concerns Kennecott's business in gold, silver and molybdenite which was held in *Chase* I to not be part of the unitary business.

1. The property factor is a fraction, the numerator of which is all the California property of the unitary business and the denominator of which is the total property everywhere of the unitary business. Chase's argument regarding the property factor is based on a claim that the business' California property was valued at what Chase calls "current value" whereas the out-of-state mines were valued at original cost. J.S. 36. Chase's claim is not supported by the record. Reference is made to *Chase* II for a full discussion (J.S. App. 45-48) of the valuation of the mines, including a recognition that Chase's proposed use of the "Hoskold's Formula" is only a rough approximation. In any event, in computing the property factor original cost was used as to each piece of property, whether or not it was in California. Chase now recognizes this as to the mining properties; however, as to the California property Chase *deletes* from its Appendix G the language from paragraph 11(a) of the stipulation of facts which establishes that *original cost was used as to each piece of California property.*[13] The facts cannot be discarded so easily.

13. "The amount of all depreciable California property as used in the allocation schedule and in the deficiency tax assessed by defendant and herein in issue was federal tax basis which was the same as net book value, i.e., cost less depreciation. As inventories and land are not depreciable, their amount was computed at cost. Freight to California was included in this cost. Chase calculated its inventory costs on the Lifo (Last In—First Out) basis."

The record does not show when the California property, consisting of real estate, office furniture, fixtures, machinery and equipment as well as inventories, was acquired. There is nothing to support Chase's implied claim that it was *all* acquired in 1954.

Thus original cost was used both in the numerator and the denominator of the property factor. As pointed out in *Chase* II (J.S. App. 47), the current California statute (reflecting the later adoption by California of the Uniform Division of Income for Tax Purposes Act) clearly provides for the valuation of property at its original cost. This is consistent with the need for practical tax administration: it should always be possible to determine the original cost of property from the books of a business, whereas the determination of present fair market value of each asset of a company would encompass considerable turmoil, uncertainty and complications. The Board's practice of balancing original cost against original cost on the property factor certainly at least satisfies the "rough approximation" standard set in *International Harvester Co. v. Evatt* (1947) 329 U.S. 416, 422.

2. Chase objects (J.S. 36-37) to the manner used by the Board and approved in *Chase* II for adjusting the property and payroll factors in response to the *Chase* I holding that for the years at issue Kennecott's business involving metals other than copper was not part of the unitary business. Said adjustments are summarized generally in *Chase* II as follows:

> "After the remand, the Board first determined the percentage relationship between the sales of other metals and total sales for each year; then it applied this percentage to the payroll and property factors and subtracted the resulting amounts from the total payroll and total property factors to obtain the final denominator for each factor."
>
> J.S. App. 51-52 (footnote omitted).

This approach was based on the Board's position that, as affirmed in *Chase* II (J.S. App. 52-53) the other metals were joint products with the copper. In its jurisdictional statement Chase does not now challenge the treatment of the other metals as joint products with the copper; what Chase does challenge is the accuracy of the figures used in separating those joint products for purposes of adjusting the property and payroll factors.

The irony of Chase's present position is that, when the Board first revised its figures in 1971 in preparation for the remand trial after *Chase* I, the Board used the best figures then available to it, and *invited Chase to supply more exact figures to be used by the Board in applying its joint products approach.* Yet Chase never offered figures into evidence at the remand trial to establish that, in applying the *Board's* joint products theory, more exact figures would lead to factor adjustments more favorable to Chase. In fact, as shown in affidavits filed in *Chase* II, when Chase finally did supply some more exact figures to the Board, and the Board applied these figures and reported to Chase that use of those figures apparently would *increase* Chase's tax liability, Chase broke off correspondence on this point.

Even given the lack of detail of the figures the Board had to work with, the Board's adjustment of the payroll factor was reasonable since it was based on the relative sales ratio being applied to *all* of Kennecott's payroll, including payroll at mines and other facilities producing no molybdenite as well as payroll at those facilities producing considerable amounts of molybdenite. Chase looks at the resulting figure only with regard to facilities which produced no or very little molybdenite and claims that the Board has overstated the amount of Kennecott payroll which is attributable to the other metals. Chase ignores

the fact that the figure reached by the Board would appear to be understated if one were only to look at the facilities which produced much molybdenite. Chase would also apply its myopic approach to scrutiny of the property factor; it is submitted that the same principles apply to render reasonable the Board's property factor computations.

An analogy would be to consider a person with three paper bags, one with ten apples, one with two apples, and one with no apples. Obviously the average is four apples per bag. Yet Chase would point at the empty bag and say that any such result is a "palpable error" which cannot be ignored.

I. THERE CAN BE NO VALID CHALLENGE IN THIS CASE ON GROUNDS OF MULTIPLE TAXATION TO CALIFORNIA'S USE OF THE STANDARD THREE-FACTOR APPORTIONMENT FORMULA.

On pages 29 through 32 of Chase's Jurisdictional Statement Chase claims that this Court should take jurisdiction because of its argument that the holding in this case, when viewed with the Utah case of *Kennecott Copper Corp., et al. v. State Tax Commission of Utah* (1972) 27 Utah 2d 119, 493 P.2d 632, *appeal dismissed,* 409 U.S. 973, would lead to double taxation. In the Utah case, decided after review of *Chase* I had been rejected by this Court, the taxpayer applied the standard three-factor formula to its unitary business. After noting a great drop in tax revenues arising from this formula, the Utah Supreme Court agreed with the Utah taxing authorities that the standard formula should not be followed and that formula apportionment should be applied to segments of the unitary business only *after* making a segregation of the unitary income through the use of separate accounting. Through this method the Utah tax revenues were increased significantly, although

the dissent in the Utah Supreme Court noted that the Uniform Division of Income for Tax Purposes Act (UDITPA) had the assumption that the standard three-factor formula would normally be applied by all states and "'that 100 percent of income, and no more and no less, would be taxed.'" 493 P.2d at 638.

The taxpayers in the Utah case, *including Chase as well as Kennecott,* appealed to this Court (No. 72-319). They claimed that the Utah decision led to unconstitutional multiple taxation, and they recognized the power of other states to continue to apply a three-factor formula. On page 18 of their 1972 jurisdictional statement appellants recognized that states other than Utah "have every right, constitutionally, to impose a tax on a fair share of corporate income." Taxpayers continued as follows:

> "Again, we know of no argument which could be made . . . to persuade those states that they should somehow defer to Utah in the matter. It has been twice held that the corporation conducts a unitary business; [footnote omitted citing *Chase* I and the Utah decision] therefore, *any state would clearly be justified in taxing a portion of total corporate income as apportioned by the three factor formula.*" (Emphasis added; footnotes omitted.)

The State of California filed in this Court an *amicus curiae* brief in favor of the taxpayers in the Utah case, in which we argued that Utah's *divergence* from the standard treatment of multistate unitary businesses appeared to present a serious federal question to which the Court might want to address itself. As noted below, this was not a recognition that application of the standard three-factor formula would present a substantial federal question. This Court dismissed the appeal in the Utah case for want of substantial federal question. 409 U.S. 973 (1972).

For the following reasons, there is no significant federal question regarding double taxation presented here:

1. In testing whether a state taxing statute would result in unconstitutional multiple taxation, this Court looks to the result which would occur if other states adopted the *same* approach as the statute being tested. *See Adams Mfg. Co. v. Storen* (1938) 304 U.S. 307, 311; *Western Live Stock v. Bureau* (1938) 303 U.S. 250, 255-56. Here California has used the standard three-factor formula allocation approved by this Court in *Butler Bros. v. McColgan* (1942) 315 U.S. 501. Further, this Court has recognized "the context of general use of the three-factor approach". *Gen. Motors v. District of Columbia* (1965) 380 U.S. 553, 559. Thus the fact that Utah has used a method diverging from the standard method used by California and other states does not give rise *in the current case* to a constitutional question of multiple taxation. This was recognized in the above quotation from the taxpayers' (including Chase) jurisdictional statement in the Utah case.[14]

2. Contrary to the result of the uniform use of the three-factor formula, if *all* states adopted the Utah approach, there would be multiple taxation. If the Utah procedure presented no substantial federal question, as this Court held contrary to our *amicus* position in 1972, then the application of the standard three-factor formula by California certainly presents no substantial federal question.

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14. It was also stated, on page 7 of the *amicus* brief (in the Utah case) of the Committee on State Taxation of the Council of State Chambers of Commerce and the National Association of Manufacturers, that when one state, such as Utah, taxes more than its apportioned share of income "the other states cannot be expected to, and will not, reduce their taxes to accommodate the overreaching state."

3. For the tax years involved in this case the Utah case can present no constitutional question of multiple taxation. The case at bar involves the years 1954 through 1956. The Utah case deals with the Utah law only as it existed after a 1967 change to said law.

V. The Arguments of Amici Curiae Are Untenable.

Briefs have been filed in this matter in which amici curiae Financial Executives Institute and Tax Executives Institute Inc., Committee on State Taxation of the Council of State Chambers of Commerce, and National Association of Manufacturers have argued in support of appellant Chase's position. No substantial arguments have been raised in those briefs which have not been answered in the balance of this motion to dismiss or affirm; thus no separate response shall be made to said briefs.

CONCLUSION

For the reasons set forth above, it is submitted that this Court should dismiss this appeal or, in the alternative, affirm the decision of the California Court of Appeal.

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Respectfully submitted,

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Appendix A

Section 25101 of the California Revenue and Taxation Code (as renumbered from section 24301 in 1955) provided as follows during 1954 through 1956:

> 25101. When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State; provided, however, that any such factors or other method of allocation shall take into account as income derived from or attributable to sources without the State, income derived from or attributable to transportation by sea or air without the State, whether or not such transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country. Income attributable to isolated or occasional transactions in states or countries in which the taxpayer is not doing business shall be allocated to the state in which the taxpayer has its principal place of business or commercial domicile.
>
> If the Franchise Tax Board reallocates net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to him the basis upon which its reallocation has been made.

Section 25104 of the California Revenue and Taxation Code (as renumbered from section 24303b in 1955) provided as follows during 1954 through 1956:

25104. In the case of a corporation liable to report under this part owning or controlling, either directly or indirectly, another corporation, or other corporations, and in the case of a corporation liable to report under this part and owned or controlled, either directly or indirectly, by another corporation, the Franchise Tax Board may require a consolidated report showing the combined net income or such other facts as it deems necessary. The Franchise Tax Board is authorized and empowered, in such manner as it may determine, to assess the tax against either of the corporations whose net income is involved in the report upon the basis of the combined entire net income and such other information as it may possess, or it may adjust the tax in such other manner as it shall determine to be equitable if it determines it to be necessary in order to prevent evasion of taxes or to clearly reflect the net income earned by said corporation or corporations from business done in this State.